

Raptor Analysis

10/1/01

- 1) The company's calculation of impairment of its receivables from the Raptor entities through the second quarter indicated an impairment loss of \$37 million. That calculation however, aggregated net losses from one Raptor entity with net gains from other Raptor entities. If we conclude that that aggregation is inappropriate, the issue is whether the financial statements are materially misstated, thereby requiring restatement of the first or second quarter.
- 2) Had the company applied its impairment calculation separately for each Raptor entity (i.e. not aggregated), a preliminary analysis suggests that the impairment loss would have been materially greater. That fact suggests that restatement may be necessary.
- 3) However, had the company measured its impairment differently, using a method allowable under GAAP, perhaps the resulting impairment charge would not have been materially different from the \$37 million loss the company has recorded. If so, no restatement may be appropriate.
- 4) Some of the issues that the company must address are:
 - a) Did the company adopt an accounting principle for calculating its impairment charge in the first and second quarters, even if the company misapplied that calculation? That is, does the misapplication of an accounting principle nevertheless lock the company into that application? Or, is the company free to choose any acceptable method of evaluating impairment in assessing whether it needs to restate?
 - i) In making this assessment, we strongly recommend that we inform the company immediately of our conclusion that aggregation is not acceptable, so that the company can begin the process of determining the possible need for restatement.
 - ii) In evaluating whether the company is free to choose an accounting method, the company should consider at least:
 - (1) Its practice and written materials related to the Raptor transactions from inception (early in 2000) to date and to what extent it has defined and applied a certain method of assessing the impairment of its receivables from the Raptor entities
 - (2) Its practice and written materials related to assessing impairment with other transactions
 - (3) Any disclosures in its public filings that address its accounting principle or methods for assessing impairment
 - b) If the company is free to choose its method, would the following be acceptable under GAAP?
 - i) The company would assess whether its receivables are impaired using judgment, rather than an objective formula, in determining whether it is probable that the company would not collect its receivables as contractually due.

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- ii) To guide the company's judgment, the company would apply the following:
 - (1) Derivatives related to certain volatile equity investments are driving many of the Raptor entities' liabilities. The company would conclude that any derivative indexed to an equity investment that has been "underwater" (i.e. resulted in a liability related to the derivative) for more than 6 months has experienced an "other than temporary decline" in value. That is, the company would value those derivatives at fair value at the date of the impairment assessment and would not assume that the value of the underlying equity security would increase in the future.
 - (2) The company would value any derivative related to a company in bankruptcy at fair value at the date of impairment and would not assume that that value of the underlying equity security would increase.
 - (3) The company would value derivatives on equity investments that are "close to cash burnout" at their fair value at the date of the impairment assessment and would not assume that the value of the underlying equity security would increase in the future. For purposes of this test, close to cash burnout means that the related entity is consuming cash at a rate that would eliminate its cash resources, including currently available financing, within one year from the date of the impairment test.
 - (4) For all other derivatives that are driving the Raptor entities' liabilities and assets, the company would perform some quantitative analysis (using Monte Carlo simulation or other analysis) to estimate either value or future cash flows for purposes of assessing impairment. Those methods necessarily involve considerable judgment. However, the quantitative analysis should start with and be consistent with the current fair value of the instrument.
 - iii) We would accept the method outlined above, assuming that the company is free to choose its method, and it elected to follow an approach with those attributes. Whether the company needed to restate the first two quarters would be dependent on the results of applying the method outlined above to the company's particular facts.
- 5) To assist with our analysis of the company's position, we will need the following facts:
- a) What is the company's position on whether it is free to choose an accounting method to assess whether it needs to restate its quarters (see item 4a above) (i.e. Does the company believe that it has established an accounting policy or method for assessing impairment for its receivables related to the Raptor entities?)
 - b) Assuming that the company is free to choose its method of assessing impairment, which method does it choose?
 - c) Which companies that are driving Raptor entities' liabilities have been "underwater" for more than 6 months?
 - d) Which companies that are driving the Raptor entities' liabilities are in bankruptcy? When did those companies declare bankruptcy?
 - e) Which companies that are driving the Raptor entities' liabilities are near "cash burnout"?

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- f) Did the company purchase the equity interest in the Raptor entities in the third quarter, thereby locking in the total loss from those transactions?
- g) Did Raptor hedge with the company a decline in the company's stock price? If so, when and at what stock price?
- h) What has the company disclosed to date in its 2000 and first and second quarter 2001 filings about the Raptor transactions?
- ? { i) Are the company's receivables from the Raptor entities "loans" (and thus fall under Statement 114) or "securities" (and fall under Statement 115)?
- j) Within the Raptor entities, is the third party equity always in the most subordinate position relative to all other Raptor liabilities and claims?